



Fitch Rates San Diego County, California's \$96MM TRAns 'F1+'; Upgrades \$1.47B L-T Debt to 'AA'

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Fitch Ratings-San Francisco-31 May 2007: Fitch Ratings has assigned an 'F1+' rating to San Diego County, California's (the county) \$96 million tax and revenue anticipation note (TRAN) program note participations, series 2007A. The notes are scheduled for negotiated sale on or about June 5 by Citi. The notes will be dated July 3, 2007 and will mature in 12 or 13 months, with the maturity determined closer to pricing.

Additionally, Fitch has upgraded the rating on several long-term debt issues to 'AA' from 'AA-', and assigns an implied general obligation (GO) rating of 'AA+'. The Rating Outlook is Stable. The rating upgrade applies to the following obligations:

San Diego County, California

--\$1.21 billion in pension obligation bonds;

San Diego County Asset Leasing Corp

--\$228.8 million outstanding certificates of participation (COPs);

San Diego Regional Building Authority

--\$29.3 million COPs.

Note proceeds will supplement the county's cash flow needs during fiscal 2008.

Fitch's highest short-term rating reflects the high coverage of note repayment and set-asides provided by projected pledged revenue, substantial borrowable funds, and the county's strong, long-term credit characteristics. The rating upgrade is based on the county's positive financial trend, marked by consistent operating surpluses and resulting high fund balances, disciplined pension system funding, and positive actions to limit other post-employment benefit costs, sound underlying economy, and conservative debt management. Fitch recognizes the fiscal uncertainty presented by a recent Court of Appeals ruling regarding the County Medical Service (CMS) program, but believes the impact to be manageable given the county's strong fiscal discipline and existing solid financial position. The rating also considers possible weakening in the real estate market, given the strong run-up over the last several years.

San Diego County's TRAns borrowing for fiscal 2008 is well protected by early note repayment set-asides, good coverage of these payments, and sizable, borrowable funds if general county operations vary greatly from the projected cash flow. This note borrowing is significantly smaller in size than prior years, reflecting greater internal liquidity and internal funding of the Teeter Plan payments of property taxes to overlapping governments. The county covenants to set-aside receipts into a repayment account in January, April, May, and June, equaling 30%, 30%, 15%, and 25% of note principal, respectively. Interest segregation is not required by the legal documents, but is set aside with principal by county practice.

The projected cash flow shows that the county can comfortably make the set-asides, with coverage

ranging from 14.3 times (x) to 38.3x. Total principal and interest is covered a sound 34.3x by projected general fund receipts. The cash flow holds up well under Fitch's stress scenarios which simulate revenue delays and expenditure gains above budgeted levels. Also, sizeable non-general fund amounts are available for borrowing to cover any cash flow variances. Identified borrowable resources are projected to total \$261.8 million at June 30, 2008, providing a sizable cushion against cash flow variance.

The general fund cash flow is based on the county's proposed fiscal 2008 budget. The proposed general fund spending plan totals \$3.5 billion, a moderate rise from projections for fiscal 2007, largely reflecting salary and benefit cost increases. The budget is balanced using \$164.5 million in prior years' fund balance. Fitch views this level as an acceptable amount given the county's sizable reserves and use of the fund balance for one-time capital expenses and departmental reserves. Also, the county budgets conservatively and has produced better than budgeted results in most fiscal years. The proposed budget includes reserves set in accordance with county policy, exceeding the target level of 17% of general purpose revenue, which equates to nearly 5% of total general fund appropriations.

Financial operations remain healthy, benefiting from the county's economic growth and related revenue generation as well as prudent spending and adherence to strong financial policies. Audited results for fiscal 2006 show the general fund running its fifth and largest operating surplus in the last seven fiscal years. The unreserved general fund balance rose to \$625.9 million, 22.2% of the year's \$2.8 billion in spending. The county expects fiscal 2007 to show a smaller operating surplus, again protecting the healthy year-end levels. Prudent management efforts contribute to long-term fiscal stability via sound operating policies and procedures, including five-year forecasts, two-year budget planning, and close monitoring of departmental operations.

San Diego County's pension system, run by the San Diego Employees Retirement Association (SDCERA) is sufficiently funded, benefiting from the county's issuance of pension obligation bonds, good investment performance, and recent county discretionary contributions. The system is 83.6% funded as of June 30, 2006. The county contributed \$90.9 million above the required amount in the last three fiscal years, with another voluntary addition included in the fiscal 2008 proposed budget.

A recent Court of Appeals ruling rejected the county's new income limit for eligibility in CMS, a program that provides health care to indigent individuals not qualifying under other programs. Previous, a lower court had approved the new and higher income limit. The county board is determining whether or not to appeal the recent decision, make changes to the eligibility requirements, or a combination of both. Fiscal 2007 was the first full fiscal year with the lower court-approved expanded eligibility, which the county estimates raised ongoing costs about \$3.5 million to \$66.3 million total county funds budgeted. The cost increase likely to result from the recent ruling cannot be determined until some idea of the remedy is available. However, Fitch believes that even if the county's net cost rises substantially, the amount is manageable given current resources and the county's strong financial practices to date.

The county Board of Supervisors and the SDCERA board have both taken actions that will significantly reduce retiree medical care expenses. The actions eliminate this benefit for employees who retired after March, 2002, when pension benefits were enhanced. The county will decide whether to continue to fund medical insurance costs for pre-March 2002 retirees without receiving the reimbursement SDCERA has provided from excess investment earnings to date. By restricting the county's exposure to a closed group of existing beneficiaries, the annual cost is expected to reduce to about \$26 million annually from an actuarially estimated amount of \$60-\$70 million.

The county's economy continues its strong performance, with resilience during the past recession notable. Employment gains have been steady, averaging 1.7% per year from 1999-2006 and experiencing no annual decline during this period. The county's unemployment rate remains below state and national averages. Tax base growth has been considerable, 10.3% per year on average from fiscals 2000-2007 and resulting from both new construction and value increases. Slowing is evident, however. The employment and tax base is diverse, including as major sectors government including a large military component, professional and business services, tourism, and education and health services. Biotechnology in particular adds to the county's diversity.

San Diego County is a conservative debt issuer, opting to cash fund projects when resources become available and utilizing one-time revenue for early debt reduction as well. The county's total direct debt is low, totaling \$1.6 billion, net of certain pension obligation bonds economically defeased. Including overlapping debt the ratios are low, at \$2,213 per capita and 2.2% of assessed value.

Fitch has upgraded the following issues to 'AA' from 'AA-':

San Diego County

--Pension obligation bonds (series 1994A, 2002A, 2002B, 2002C, 2004A, 2004B and 2004C).

San Diego County Capital Asset Leasing Corp.(SANCAL):

--1997 Central Jail Refunding;

--1998 Downtown Courthouse Refunding;

--1999 East Mesa Refunding;

--2005 Edgemoor & RCS Refunding;

--2006 Edgemoor Completion Project.

San Diego Regional Building Authority:

--Series 2001 (MTS Tower Refunding).

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